

STATE OF CALIFORNIA  
**ELECTRICITY OVERSIGHT BOARD**



Gray Davis, Governor

Testimony of  
**Michael A. Kahn**  
**Chairman, Electricity Oversight Board**

Before the  
Joint Hearing of the  
Assembly Utilities and Commerce Committee  
And the  
Senate Energy, Utilities, and Communications Committee

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**I. INTRODUCTION**

My name is Michael Kahn. I am Chairman of the Electricity Oversight Board. Thank you for inviting me to appear before you today.

**II. DESCRIPTION OF THE PROBLEM – WHY ARE WE HERE?**

Our system of delivering electric service to Californians is in difficult straits. Last week President Lynch and I sent to Governor Gray Davis a report entitled, *California's Electricity Options and Challenges: Report to the Governor*.<sup>1</sup> It describes the difficult situation facing California. And it suggests a number of solutions to the difficulties we have seen this spring. I wish to highlight three primary issues in my remarks before you today:

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<sup>1</sup> Referred to hereafter as The Report or The Report to the Governor.

- The price of power flowing through the California Power Exchange (CalPX) and through the California Independent System Operator (CAISO) is much higher – higher than last year, higher than California expected under our restructured environment, and higher than the costs were under the old regulated monopoly system. Though most Californians have not yet experienced the direct effects of those higher prices, many have – particularly the residents of the San Diego area.
- The pattern of high prices, which have occurred mostly at times of high load levels, has led many, including me, to conclude that the market for power is not workably competitive. We cannot rely on that market to produce reasonable combinations of price and quantity all of the time. In fact, there are normally recurring circumstances during which we can almost certainly be guaranteed to receive very high-priced energy from the CalPX and the CAISO.
- It seems that California's entire electric system is straining – barely enough generating power, worries about power reliability and quality, frequent interruption of those customers who volunteered to be interruptible, and some interruption of service to customers who have come to rely on firm, reliable service.

Various temporary and emergency solutions to the most immediate symptoms of our problems are being proposed, including one to bring a floating power station into San Francisco Bay. That project has been withdrawn now. But I wish to call your attention to a comment about that proposal. Will Travis, the Executive Director of the San Francisco Bay Conservation and Development Commission said, "The commission was skeptical as to whether the emergency really existed."<sup>2</sup>

Now, the barge proposal is gone, and Mr. Travis may well be right about the specifics of that proposal. Nonetheless, there really is an emergency regarding California's electric supply and delivery system. It is unacceptable to the Governor and

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<sup>2</sup> San Francisco Chronicle, "PG&E Abandons Power Plant Plan for Barge in Bay," August 5, 2000, page one and following.

to me that this basic system is straining at the edge of its capabilities and that the costs we Californians are paying for electric service are so high. I am sure that it is unacceptable to you as well. The current state of affairs is not what the Legislature or the Public Utilities Commission had in mind several years ago when our State embarked on the path to restructuring.

At the same time, this is not an invitation to panic. The current situation is one that has come upon us over a number of years, and it will take a while for us to get out of it. *The Report* proposes a series of actions – some of which are aimed at alleviating conditions in the short run, and some of which will help in the longer run – to assure that Californians can depend on a system that “provides competitive, low cost and reliable electric service.”<sup>3</sup>

The Executive Summary to *The Report* outlines four separate components that jointly affect electricity reliability and prices. *The Report* presents three sets of potential actions: to prepare for an electricity emergency; to prevent current electricity problems from spreading in 2001; and to consider or act on within the next six months. I will not repeat those items here. They are available in *The Report’s* Executive Summary. More detailed information is included in the text itself.

### **III. A FEW FACTS, NOT ALL OF THEM UNPLEASANT**

The current electricity situation did not come upon us without warning. Indeed, as *The Report to the Governor* demonstrates, a number of factors have come together over time to bring us to this state of affairs.

- Our State’s economy has been growing quite steadily for nearly a decade, adding jobs, adding commercial and industrial activity, adding residents, and adding housing. This prosperous economy is something for which we are all grateful.
- Our State’s demand for electric energy also has been growing – at a faster rate than was anticipated just a few years ago. The high-tech industries that have

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<sup>3</sup> AB 1890, Section 1.

chosen to locate in California have added not only to our prosperity but also to our electrical demands.

- At the same time as California's electric loads have been growing, the capacity of electric generating facilities has not been growing nearly as quickly.
- Not all of the electricity Californians use is produced at power plants located within the State. Ours is a large and integrated electric system extending beyond state lines. For many reasons, including environmental reasons, we have depended on imported electricity for a share of our needs.
- The states that surround California – Arizona, Nevada, and Oregon – along with all of the other states in the West, have also seen bright economic growth and rising electric consumption levels.
- With economic growth and demand growth, the previous surplus of generating capacity throughout the West no longer exists. Add to that a relatively dry water year, resulting in less hydroelectric generation available from the Northwest.
- It all adds up to a short supply, particularly at the hours of highest need.
- With most things that people buy, they can see the cost and make choices about how much to consume and when to make their purchases. However, most California customers do not receive timely information about the best electricity use patterns and when to conserve if possible. This situation is not conducive to development of flexible consumer responses to price signals.
- There are some limitations on California's electric system even within the state. The outages in the Bay Area in June were not caused by a limitation on the overall supply of power in California, but of the ability to move that supply into the Bay Area where some generators were out of service at that time.
- Other factors aggravated this difficult situation during the spring of 2000. The price of natural gas – the fuel used in power plants that meet our peak needs – is

about double what it was a year ago. However, higher gas prices alone cannot account for the difference in electric energy prices from last year to this year.

- Another factor that surprised Californians this spring was that it got hot all over the State earlier than was expected. The heat spread throughout the West, resulting in less out-of-state power being available for import.
- Ultimately, what we are now seeing is high electric energy prices for California. For the first several months of 2000, prices out of the CalPX were somewhat higher than last year – about 10 dollars higher on average. However, beginning in May, things really got out of hand. I have a few numbers that represent monthly averages from the CalPX Day-Ahead market. In May this year, the average price was \$50 per MWh, where a year before it had been about \$25 – half as much. As bad as that sounds, it got worse in June. The June 2000 average was \$132 per MWh. That is more than five times the June 1999 average of \$26 per MWh. Conditions were only slightly improved in July, as the average dropped to \$115 per MWh. These are not peak prices. They are averages that include the low-cost hours of the night and early morning. They are high beyond our expectations, and they are higher than we should have to pay from an orderly and competitive market.

#### **IV. PRELIMINARY CONCLUSIONS**

The conditions that brought us this year's electrical crisis have been building for some time. They are normal recurring conditions in California, not anomalies that we can hope will not pass our way again. The economic growth is a blessing, not a curse. However, the increase in electrical demand that comes with that growth is a fact that Californians must face.

The combination of high demands and strains on the limited system of generators and transmission lines that are not increasing in capacity as quickly as those demands has left California vulnerable to outages and to high prices. When demands rise and supplies are tight, prices can become separated from costs. In the current situation in California,

we should not be surprised that bidders have found that they can bid prices well above their costs and that prices have risen to the level of the price caps on many occasions this year.

It is likely that high demand levels will continue this summer, and we may have another bout of very hot weather before the summer is over. Even if our peak level of demand is over for this year, soon many of those power plants that strained to be available during the hottest part of the summer will need to be taken out of service for maintenance. So even as our demand for power begins to recede, the potential supply also will decline. Californians may find themselves in a situation of tight supply long into the fall.

Nor should it be expected that the situation will be different next year. The factors that have brought us to this moment are likely to continue. Over the next several years, the forecast is that demand for electrical energy will continue to grow; generation capacity will remain tight; transmission facilities upgrades will continue to move along very slowly; and consumers of electric power will remain largely insulated from information that could help them to modify their electric consumption patterns. In other words, we should expect that current conditions will not change immediately. We must recognize that for a while at least, there will be more of the same.

I continue to work with President Lynch to investigate the events that occurred during May and June this year and the prices that issued from our markets. We are continuing to receive and analyze information, and we will continue to report the results of our work.

Governor Davis has appointed me, President Lynch, and several others to a new Task Force on Energy Reliability to consider, coordinate and advise him on energy generation, reliability, siting, conservation, and efficiency policies. To that task force, I am carrying all of the recommendations in *The Report*. The Governor also has called for a number of administrative actions through executive orders of August 2.

I am also pleased that U.S. President Clinton issued a statement on August 3 on potential electricity shortages in California. With that statement he included a memorandum to the heads of executive departments and agencies directing them to reduce consumption of power to the maximum extent practicable and to coordinate with other agencies. He also directed that the federal agencies that generate electricity take all possible measures to maximize the amount of power that can be delivered to California.

Finally, on the Governor's behalf, I want to point out that whatever actions the Governor's Task Force takes, whatever actions the administrative agencies undertake, and whatever the Legislature wishes to take, should be thoughtful and deliberate. As I stated at the beginning of this testimony, there is a real emergency. But as in any other emergency, the best responses, those that will serve Californians best over the weeks, months, and years ahead, will be those that are well thought out and grounded in facts.

This concludes my prepared testimony. I would be happy to take your questions.

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